DEPARTMENT OF STATE REVENUE

04-20140144.LOF

Letter of Findings: 04-20140144
Use Tax
For the Years 2011 and 2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective as of its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register.

ISSUE

I. Use Tax–Imposition.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-8; IC § 6-2.5-5-9; IC § 6-8.1-5-1; Indiana Dep't of State Revenue v. Indianapolis Transit System, 356 N.E.2d 1204 (Ind. Ct. App. 1976); Brambles Industries, Inc. vs. Indiana Dep't of State Revenue, 892 N.E.2d 1287 (Ind. Tax Ct. 2008); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Tri-States Double Cola Bottling Co. v Department of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999); 45 IAC 2.2-5-15; 45 IAC 2.2-5-16; Black's Law Dictionary (9th ed. 2009).

Taxpayer protests the imposition of use tax on its purchase of chemical storage tanks.

STATEMENT OF FACTS

Taxpayer is an Indiana business. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's business records. As a result of the audit, the Department determined that Taxpayer owed additional use tax for the 2011 and 2012 tax years. The Department found that Taxpayer had made purchases on which sales tax was not paid at the time of purchase nor was use tax remitted to the Department, and issued proposed assessments for the additional use tax and interest due for the purchases. Taxpayer protests the imposition of use tax on its purchase of storage tanks. An administrative hearing was held, and this Letter of Findings results.

I. Use Tax–Imposition.

DISCUSSION

All tax assessments are prima facie evidence that the Department's claim for the tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). In general, all purchases of tangible personal property are subject to sales and/or use tax. An exemption from use tax is granted for transactions where sales tax was paid at the time of the purchase pursuant to IC § 6-2.5-3-4. In certain circumstances, additional enumerated exemptions from sales and/or use tax are available.

The Department found that Taxpayer made purchases without paying sales tax at the time of the purchases, and assessed use tax on the purchases. Taxpayer protests the assessment of use tax on its purchase of chemical storage tanks.

The audit report found that Taxpayer had purchased and used the tanks as a means to deliver chemicals to its customers. Since sales tax was not paid at the time of purchases, the Department assessed use tax on the purchases.

Taxpayer first asserts that pursuant to direction it received during a prior audit, it did not pay sales or use tax on

the chemical storage tanks. However, a review of the prior audit does not reveal this to be the case. In fact, the only determination made about tanks in the prior audit, on page 3 of the audit report, determined that Taxpayer's purchase of the tanks were subject to use tax.

Taxpayer's protest letter goes on to state:

> In addition, the statement in the explanation of adjustments . . . that reads:
>
> > In some cases, the product is transferred into the tank at the customers' site. Other times they deliver the product in the tank.
>
> is incorrect. These tanks are not approved by the US DOT for transportation of hazardous materials and at no time in our delivery process carry any product. They are delivered empty and returned empty. This material fact is relevant because we believe that it changes the [auditor's] finding that:
>
> > The tanks should not be construed as non returnable containers and are not being allowed the exemption.

(Emphasis in original).

However, even if the statement in the audit that sometimes Taxpayer "deliver(s) the product in the tank" is incorrect, this does not change the outcome of the auditor's finding. The tanks in question are "returnable containers" that are returned to Taxpayer. In fact, Taxpayer's customers sign an "Equipment and Tank Agreement" that provides that "[Taxpayer] will loan [the tank] to you at no charge in connection with your purchase of [products] from [Taxpayer]." This agreement requires the customer to return the tank at Taxpayer's request and requires reimbursement if the tank is not returned to Taxpayer. Therefore, Taxpayer's purchase and use of these containers–even when all of the containers are delivered empty and returned empty–does not qualify for exemption and is subject to sales and use tax.

IC § 6-2.5-5-9 (as in effect prior to the July 2012 amendment since the amendment is not relevant to the discussion) provides a limited exemption for certain returnable and non-returnable containers, as follows:

> (a) As used in this section, "returnable containers" means containers customarily returned by the buyer of the contents for reuse as containers.
> (b) Sales of returnable containers are exempt from the state gross retail tax if the transaction constitutes selling at retail as defined in IC § 6-2.5-4-1 and if the returnable containers contain contents.
> (c) Sales of returnable containers are exempt from the state gross retail tax if the containers are transferred empty for the purpose of refilling.
> (d) Sales of wrapping material and empty containers are exempt from the state gross retail tax if the person acquiring the material or containers acquires them for use as nonreturnable packages for selling the contents that he adds.

Additionally, the Department refers to 45 IAC 2.2-5-16, which states:

> (a) The state gross retail tax shall not apply to sales of nonreturnable wrapping materials and empty containers to be used by the purchaser as enclosures or containers for selling contents to be added, and returnable containers containing contents sold in a sale constituting selling at retail and returnable containers sold empty for refilling.
> (b) In general the gross proceeds from the sale of tangible personal property in a transaction of a retail merchant constituting selling at retail are taxable. This regulation [45 IAC 2.2] provided an exemption for wrapping materials and containers.
> (c) General rule. The receipt from a sale by a retail merchant of the following types of tangible personal property are exempt from state gross retail tax:
> (1) Nonreturnable containers and wrapping materials including steel strap and shipping pallets to be used by the purchaser as enclosures for selling tangible personal property.
> (2) Deposits for returnable containers received as an incident to a transaction of a retail merchant constituting selling at retail.
> (3) Returnable containers sold empty for refilling.
> (d) Application of general rule.
> (1) Nonreturnable wrapping material and empty containers. To qualify for this exemption, nonreturnable wrapping materials and empty containers must be used by the purchaser in the following way:
> (A) The purchaser must add contents to the containers purchased; and

(B) The purchaser must sell the contents added.

(2) Returnable containers sold at retail with contents. To qualify for this exemption, the returnable containers must be:

(A) Sold in a taxable transaction of a retail merchant constituting selling at retail; and

(B) Billed as a separate charge by the retail merchant to his customer. If there is a separate charge for such containers, the sale of the container is exempt from tax under this regulation [45 IAC 2.2].

(3) Returnable containers sold empty. To qualify for this exemption the returnable container must be resold with the purpose of refilling. The sale of returnable containers to the original or first user thereof is taxable.

(e) Definitions.

(1) Returnable containers. As used in this regulation [45 IAC 2.2], the term returnable container means containers customarily returned by the buyer of the contents for reuse as containers.

(2) Nonreturnable containers. As used in this regulation [45 IAC 2.2], the term "nonreturnable containers" means all containers which are not returnable containers.

(Emphasis added).

Accordingly, for the returnable containers that are sold empty to be purchases exempt from sales and use tax, the retail merchant must "resell" the container with the purpose of refilling and charge sales tax to the original or first user of the container. However, Taxpayer purchases the tanks and allows its customers to use the tanks by signing a "loan agreement" with the understanding that the customers will purchase the chemical products from Taxpayer. Since Taxpayer does not resell the tanks to its customers and merely "loans" them to the customer, Taxpayer's purchase and use of the tanks does not qualify for exemption as a returnable container. IC § 6-2.5-5-9 and 45 IAC 2.2-5-16.

Alternatively, Taxpayer asserts that the tanks qualify for an exemption as rental property. Taxpayer maintains that the tank rental is included in the price it charges its customers for the chemicals. Taxpayer states that its customers pay a higher price for the chemicals because the price of the chemicals includes the price for using the tanks.

Pursuant to IC § 6-2.5-5-8, "[t]ransactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property." The exemption is addressed also in 45 IAC 2.2-5-15(b) which provides, as a general rule, that "[s]ales of tangible personal property for resale, rental, or leasing are exempt from tax if all of the following conditions are satisfied; (1) the tangible personal property is sold to a purchaser who purchases this property to resell, rent, or lease it; (2) The purchaser is occupationally engaged in reselling, renting, or leasing such property in the regular course of his business; and (3) The property is resold rented or leased in the same form in which it was purchased."

The Indiana courts have provided guidance in determining whether a transaction between parties constitutes a lease agreement. In Indiana Dep't of State Revenue v. Indianapolis Transit System, 356 N.E.2d 1204 (Ind. Ct. App. 1976), the court of appeals stated that "[w]hether certain circumstances created a lessor – lessee . . . relationship between the parties is a matter of fact dependent on possession of and control over the property involved." Id. at 1209. While finding that the Department's regulation did not contain a definition of "lease," the Tax Court in Tri-States Double Cola Bottling Co. v Department of State Revenue, 706 N.E.2d 282 (Ind. Tax Ct. 1999), concluded that a "lease" constituted the "transfer of the right to possession and use of goods for a term in return for consideration." Id. at 285.

The Department is unable to agree that Taxpayer has established that it is in the business of renting this equipment to its customers "in the regular course of the purchaser's business." 45 IAC 2.2-5-15(a). A lease agreement is necessarily evidenced by "A contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 970 (9th ed. 2009). Thus, without more, simply naming an exchange of property as a "lease," even with the evidence of the payment of some kind of fee, would not necessarily make the arrangement a lease. In Brambles Industries, Inc. vs. Indiana Dep't of State Revenue, 892 N.E.2d 1287 (Ind. Tax Ct. 2008), where a manufacturer that was seeking the "resale/lease exemption" under IC § 6-2.5-5-8 for pallets by maintaining that "the price of pallet was incorporated into the price of their products" was denied the exemption, the Tax Court explained, as follows:

> Indiana Code § 6-2.5-5-8 exempts from tax "[t]ransactions involving tangible personal property . . . if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of the person's business [.]" Ind. Code Ann. § 6-2.5-5-8(b) (West 2001) (amended 2003). See also 45 Ind. Admin. Code 2.2-5-15(a) (2001). This Court has previously explained that in order to show entitlement to the sale for resale

exemption, the taxpayer must demonstrate that it received itemized consideration for the item. See Miles, Inc. v. Indiana Dep't of State Revenue, 659 N.E.2d 1158, 1165 (Ind. Tax Ct.1995) (discount coupons inserted in boxes were not resold because customers did not pay itemized amount for them); Indiana Bell Tel. Co. v. Indiana Dep't of State Revenue, 627 N.E.2d 1386, 1389 (Ind. Tax Ct.1994) (telephone directories, the cost of which was built into customers' monthly bills, were not resold for purposes of the exemption because their cost was not itemized in the bills); USAir, Inc. v. Indiana Dep't of State Revenue, 542 N.E.2d 1033, 1035-36 (Ind. Tax Ct.1989) (holding that meals provided on airline's flights were not resold because there was nothing in the price of the ticket to reflect the price of the food). "Moreover, separate bargaining must occur between the customer and the taxpayer for the exchange of that particular item." Miles, 659 N.E.2d at 1165. See also Greensburg Motel Assocs. v. Indiana Dep't of State Revenue, 629 N.E.2d 1302, 1305-06 (Ind. Tax Ct.1994) (holding that consumable and non-consumable items provided in hotel guest rooms were not resold because the hotel's customers did not bargain for those items).

Id. at 1289-90.

Taxpayer, like the manufacturer in Brambles that was seeking an exemption under IC § 6-2.5-5-8 for pallets by maintaining that "the price of pallet was incorporated into the price of their products," asserts that it charges its customers a price that includes the costs of the tank rental. Like the manufacturer in Brambles that did not separately itemize the price of the pallet, Taxpayer neither accounted for separately in the agreements nor in its customer invoices for the tank rental. Therefore, like the manufacturer in Brambles that did not qualify for the exemption under IC § 6-2.5-5-8 because it could not "demonstrate that it received itemized consideration for the item," Taxpayer that also cannot demonstrate that it received itemized consideration for the tanks does not qualify for an exemption under IC § 6-2.5-5-8. Therefore, Taxpayer has failed to meet the threshold requirement of the "resale/lease exemption" that it received itemized consideration for the equipment.

Notwithstanding that Taxpayer failed to meet the threshold requirement of the "resale/lease exemption," Taxpayer's transactions with its customers do not constitute rental transactions because Taxpayer's customers do not come into "possession" of the tanks. "Possession" means the right to "exercise control over something to the exclusion of all others." Black's Law Dictionary 1281 (9th ed. 2009). While the tanks are located on the customers' property, this does not mean that the customers have "possession." The individual customer is not entitled to move the tanks or to allow another supplier to fill the tanks with the competitor's supply of products. If the customer decides to obtain fuel from another source or decides to discontinue the use of Taxpayer's products, Taxpayer has the right to remove the tank from the customer's property. Thus, even though the tank is located on the customer's property, Taxpayer retains most of the rights to control the tank. Unlike an actual lease agreement, Taxpayer's customers do not acquire the usual rights to control the object of the lease. Instead the tanks are merely an extension of the agreement by which Taxpayer provides products to its customers, which by nature of the transaction is necessarily located on the customer's property. Taxpayer's interest lies in selling its product to its customers and receiving compensation for the cost of doing so. The customers' interest is in obtaining that product; the object of the parties' agreement is the delivery, storage, and consumption of the product.

Accordingly, Taxpayer is in the business of selling products to its customers, and the tanks are merely the means by which Taxpayer makes it possible for the customer to obtain and consume its products. Taxpayer is certainly entitled to recover from its customers the cost of providing the tanks by charging a premium on the price of the delivered product, but this additional cost is simply the price the individual customer pays for having the product delivered. However, Taxpayer has failed to meet its burden to show that it "is occupationally engaged" in the business of leasing storage tanks in the ordinary course of its business, as required by IC § 6-2.5-5-8, for its purchases of tanks to qualify for the rental exemption.

FINDING

For the reasons stated above, Taxpayer's protest is respectfully denied.

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